

## AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS



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INDEPENDENT AUDITOR'S REPORT ON  
COMPLIANCE WITH LAWS AND REGULATIONS

Inspector General  
U.S. Small Business Administration

We audited the consolidated balance sheets of the U.S. Small Business Administration (SBA) as of September 30, 2005, and 2004; and the related consolidated statements of net cost, changes in net position, and financing and combined statements of budgetary resources for the fiscal years then ended and have issued our report thereon, dated November 15, 2005. In that report, we issued an unqualified opinion on the Fiscal Year (FY) 2005 consolidated balance sheet; FY 2005 consolidated statements of net cost, changes in net position and financing; and FYs 2005 and 2004 combined statements of budgetary resources, and a qualified opinion on the FY 2004 consolidated balance sheet and consolidated statements of net cost, changes in net position, and financing.

Except as described in our November 15, 2005, Independent Auditor's Report, we conducted our audits in accordance with auditing standards generally accepted in the United States; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements*.

SBA management is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether SBA's financial statements are free of material misstatement, we performed tests of agency compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin 01-02, including requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and did not test compliance with all laws and regulations applicable to SBA.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph, exclusive of FFMIA, disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin 01-02.

Under FFMIA, we are required to report whether SBA's financial management systems substantially comply with federal financial management system requirements, federal accounting standards, and the United States Government Standard General Ledger (USSGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. Results of our tests disclosed instances, described below, indicating that SBA's financial management systems did not substantially comply with federal financial management system requirements, federal accounting standards, and USSGL at the transaction level.

Details regarding each of the matters discussed below are in our Independent Auditor's Report on Internal Control (applicable section cited below).

SBA is not in substantial compliance with federal financial management system requirements, because:

- Access control, segregation-of-duty, and other general-control weaknesses existed, which are described in the Office of Inspector General report titled *Audit of SBA's Information System Controls, FY 2005*. (3. Agency-Wide Information System Controls)
- Security weaknesses and non-conformances with OMB Circular A-130, *Management of Federal Information Resources*, continued to exist in certain major applications and general support systems. (3. Agency-Wide Information System Controls)

SBA was not in substantial compliance with federal accounting standards, because it:

- Overstated undelivered orders when it failed to deobligate unneeded obligations. (1. Financial Management and Reporting Controls, Funds Management)
- Overstated the Liability for Loan Guaranties [sic] and understated Credit Program Receivables and Related Foreclosed Property, Net, line items resulting from reversing a journal entry in error. (1. Financial Management and Reporting Controls, Financial Accounting Transactions and Review of Account Balances, Improper Automated Reversing Entries)
- Improperly accounted for its loan loss allowances in liquidating funds (1. Financial Management and Reporting Controls, Financial Accounting Transactions and Review of Account Balances, Loan Loss Allowances in Liquidating Funds)
- Overstated loans receivables and allowance for subsidy accounts at June 30, 2005, because it did not record a charge-off action timely. (1. Financial Management and Reporting Controls, Financial Accounting Transactions and Review of Account Balances, Untimely Charge-off of Loans Receivable)
- Omitted essential disclosures regarding yearend accruals to decrease disaster program undelivered orders, FY 2005 subsidy expense, activity by component in the Liability for Loan Guarantees account, and use of projected FY 2005 cashflows and balances in calculating reestimates. (1. Financial Management and Reporting Controls, Financial Statement Preparation and Quality Assurance)

SBA was not in substantial compliance with the USSGL at the transaction level, because it:

- Recorded invalid spending authority from offsetting collections, obligations incurred, and recoveries of prior-year obligations due to improper budget proforma posting logic. (1. Financial Management and Reporting Controls, Financial Accounting Transactions and Review of Account Balances, Budget Proforma Entries)
- Did not use proper posting logic when calculating an automated month-end credit reform journal entry. (1. Financial Management and Reporting Controls, Financial Accounting Transactions and Review of Account Balances, Proforma Credit Reform Accounting Transactions)

- Did not properly account for borrowing transactions (1. Financial Management and Reporting Controls, Financial Accounting Transactions and Review of Account Balances, Treasury Borrowing Transactions)

SBA's Office of the Chief Financial Officer is responsible for financial management systems within SBA. We recommend that SBA assign priority to corrective actions for these FFMI-related matters consistent with requirements of OMB Circular A-50, *Audit Followup*.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our work; accordingly, we do not express such an opinion.

This report is intended solely for the information and use of SBA management, OMB, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

COTTON & COMPANY LLP



Charles Hayward, CPA

November 15, 2005  
Alexandria, Virginia